

Matjaž Sušec in interview with Delo (Slovenia)

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Interview with Matjaž Sušec, ESM Head of Policy Strategy and Institutional Relations

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Delo: Mr Sušec, the euro rescue fund, as the European Stability Mechanism (ESM) is popularly known, is in charge of giving financial assistance to euro countries with funding and banking problems. You have helped some countries in the past. Your lending capacity exceeds €400 billion. What can the ESM offer now?

Matjaž Sušec: The ESM has several instruments at its disposal, which it can use depending on the circumstances. The ESM provided financial assistance to five

countries during the euro area crisis. In the case of Greece, Ireland, Portugal and Cyprus, the ESM loans were granted as part of macroeconomic adjustment programmes, as the countries were facing severe financing problems. In the case of Spain, the ESM loan was used for just one purpose: to restructure the country's banks.

In addition to these two instruments, which have already been used, the ESM can also offer precautionary financial assistance. These are special credit lines that a country can apply for before a crisis occurs. The aim of these credit lines is therefore to prevent crises from occurring, as they act as a form of insurance. Their purpose is to calm doubts as to whether countries can access new credit. They act as a signal of the credibility of economic policies, because the recipient country must meet certain conditions.

In addition, the ESM can also buy bonds on the market, including on the primary market, directly from the Member States, or on the secondary market, as the central banks of the euro system are currently doing.

Interestingly, Slovenia did not request your help in the past, despite its major funding problems, especially in the years preceding the bank bailout at the end of 2013.

It is correct that Slovenia did not request financial assistance from the ESM.

Since the pandemic crisis began last March, have any countries asked you for any help?

The ESM has a new credit line specifically to support countries during the pandemic. This is a credit line to finance direct and indirect healthcare costs, related to cure and prevention of the effects of the pandemic. This line was approved by the Board of Governors of the ESM last year and can be requested until the end of 2022. The only condition for accessing this credit line is that countries commit funds to cover healthcare costs associated with the pandemic. The introduction of this instrument shows that the ESM financial assistance can be tailored to the circumstances. Unlike the last crisis we saw in the euro area, the pandemic was an unexpected shock that affected everyone. Therefore, pandemic financial assistance is not conditional on the implementation of the macroeconomic measures needed to address the consequences of misguided economic policies or economic imbalances.

It has not been activated so far. It is a precautionary tool, as I explained, and works as an insurance, which means it is valuable even if it is not used. The fact that countries have not requested it so far reflects the fact that euro countries have maintained favourable access to capital markets during the pandemic, which is positive.

But to what extent is this pandemic aid possible?

Each country can apply for a credit line of up to two per cent of its GDP. If we add up all the euro countries, this makes around €240 billion available.

Roughly speaking, for Slovenia, would this mean that we still have a "pandemic" credit line of around €1 billion?

Yes, the figure for Slovenia is roughly one billion euros.

How do you see the current economic situation in Slovenia and the way we have dealt with the crisis?

The pandemic has had a major impact on the Slovenian economy, as well as on the quality of life in Slovenia. However, the negative impact on economic growth and also on employment has been lower than expected. This is mainly due to measures to support jobs, which were adopted in Slovenia, similarly to other European countries.

This is a good starting point for the recovery. As you know, the European Commission forecasts that GDP will, or has already this year, exceeded the 2019 level. Strong economic growth will continue in the next two years.

This post-pandemic period is also an opportunity to implement some reforms that pose a long-standing challenge to the Slovenian economy. One of these challenges is low productivity growth as a result of lower investment in the past, both private and public.

The pandemic has made this challenge even more acute. It is therefore important to make the most of the European Commission's NextGenerationEU instrument and to implement the reforms that are included in the Recovery and Resilience Plan.

Which reforms do you have in mind?

I am thinking in particular of the reforms for the transition to a low-carbon economy, as well as the acceleration of digitisation. If the country sticks to these measures, this could have a positive impact on economic growth in the coming years and will contribute to strengthening public debt sustainability.

Yes, we know the dynamics of public debt in our country. Before the last financial crisis, it was relatively low, just over 20% of GDP, and then it rose steadily, peaking at 86%, and now, according to official data, it is just below 80%, and we are running, and projecting to continue running, quite substantial deficits. Is this level of debt sustainable for Slovenia?

It is true that debt rose in the wake of the financial crisis and also now with the pandemic. As you mentioned, it is just below 80% of GDP this year and is lower than the euro area average, which could reach 100% of GDP this year. And the interest rates at which Slovenia can currently borrow in capital markets are much lower than in the past. The current level of public debt is sustainable. All euro area countries are now considered to have a higher capacity to repay public debt than in the past. The higher expected economic growth in the coming years will lower the level of public debt relative to GDP.

At the same time, the European Commission is now launching a debate on the revision of the fiscal criteria of the Stability and Growth Pact. These are, of course, the thresholds of three per cent for budget deficits and 60% for the public debt-to-GDP ratio. Why do these rules need to be changed?

A reform of the fiscal rules is welcome. The impetus for reform was already there even before the pandemic and the European Commission was already planning a consultation on reforming them. The main elements of the fiscal rules date back to the 1990s when interest rates were higher and the sovereigns' debt-carrying capacity was lower. Above all, these rules should be simplified.

How concretely?

By referring to realistic targets and variables that can be monitored in real time. Coming to your question on the two main fiscal criteria, ESM colleagues have recently published a study in which they suggest how to adapt the fiscal rules to the current economic circumstances. In it they find that a 3% deficit is still an appropriate rule, while the ratio of 60% of public debt compared to GDP should be reconsidered.

Why?

This rule does not take into account the current environment, in which interest rates are lower than they were 30 years ago, when the fiscal rules were written. And interest rates are expected to remain low, although they are likely to increase from today's very low level. To a large extent, this is the result of the long-term global trend towards lower interest rates driven by demographic trends, wealth inequality and low productivity trends in advanced economies. This means the sustainability of public debt, or the ability of the state to repay public debts, is and will remain greater than it was in the past. Enforcing the existing rule that sovereigns must reduce their debt by one twentieth per year, which would represent an enormous fiscal effort for some, is today no longer necessary.

Is there some political consensus within the euro area on changing the criteria?

It is too early to say, because the debate is at an early stage.

We know that the costs of an otherwise necessary green transition will also require large investments, which will also be financed with public funds. This will put further pressure on public debt. How do you see this?

If the measures that countries have set out in their recovery and resilience plans are implemented as intended, this can further boost economic growth. This is because they have an impact on the potential economic growth of countries and this has an impact on the sustainability of their public debt. In practical terms, countries can grow out of debt through higher economic growth. However, where a country invests the funds it has borrowed is very important.

Given that you are in charge of crisis resolution at the ESM, do you have any country fact-finding missions, such as those carried out by the IMF? In the sense of checking macroeconomic policies and making recommendations?

So far, the ESM has mainly monitored the ability of countries (Greece, Spain, Portugal, Ireland, Cyprus) to repay the loans they received. We visit these countries together with the European Commission, and the IMF is also present. I was the mission chief for Portugal for four years. During our joint missions, we carry out economic analyses of the repayment capacity of these countries - because our loans

are very long-term. With the ESM's new mandate, which is expected to be adopted early next year, the ESM will be able to monitor macro-financial risks across the euro area.

Does this mean that the ESM is on its way to becoming a kind of European Monetary Fund, a European version of the IMF?

Like the IMF, the ESM can help eurozone countries to overcome crises. Importantly, from the beginning of next year, the ESM will have more tasks than before. The revised Treaty establishing the ESM is currently in the process of ratification by the parliaments of the euro area Member States. In Slovenia, the National Assembly approved the law amending the Treaty in July. The first part of this reform of the ESM is the so-called common backstop for the Single Resolution Fund, which is an important contribution to completing the Banking Union.

Common Backstop: how would you explain this rather technical term in a simple way?

It is a loan that the ESM can offer to the Single Resolution Fund, which is part of the newly created Single Resolution Board. This Fund is financed by contributions from banks operating throughout the banking union area and can use its resources to finance the resolution of banks. If the Fund uses up all its resources, the ESM can lend it additional funds. This can happen in the event of a major crisis in the euro area. This way the ESM makes a further contribution to financial stability in the euro area. As the Single Resolution Fund is financed by contributions from the banks themselves, these contributions will also be used to repay the debt owed to the ESM. Therefore, this is not about spending taxpayers' money to bail out banks.

How many banks is that? Ten thousand? What do the banks say to that?

Almost all banks, large and small, have been paying these contributions since the creation of the Single Resolution Fund. This is regulated in all the 21 countries of the banking union.

What are your other new tasks?

The second part of the ESM reform strengthens the precautionary financial assistance of the ESM. The pandemic shows that an external shock can happen at any time. It is precisely this instrument that we can use to provide countries with

quick access to funds before they run into trouble.

Finally, the ESM will strengthen its cooperation with the European Commission in designing, monitoring and negotiating new financial assistance programmes. This reform is the result of several years of work and political negotiations.

In addition, I believe that more can be done to increase the resilience of the monetary union. In addition to progress on the banking union and the capital markets union, I believe that a new instrument for macroeconomic stabilisation should also be considered. This type of instrument would provide additional fiscal space for those euro area countries that would be hit by an asymmetric shock. Such a shock could be caused by natural disasters as well as by a climate transition. This is where the ESM could play an important role in the future.

An asymmetric shock assumes that one country is more affected than others, which means that it needs specific measures, a different fiscal policy.

Yes. This is important in a monetary union because in a monetary union, countries give up their own monetary and exchange rate policies. This means fiscal policy is needed more from time to time.

It is true that our experience shows us that in Slovenia, as a small, open country, we need to be more careful not to go off in a negative direction when we could be disadvantaged by an asymmetric shock. Do you agree?

This is particularly important in the current situation, when countries are emerging from a pandemic crisis with higher public debts. As I said, in some countries this debt is higher than in others. This means that in some countries the fiscal space is more limited than in others.

What is your view on the current situation of banks in the euro area?

Banks in the euro area entered the pandemic in a much better position than at the start of the euro crisis, mainly due to a better loan portfolio than they had at the time, but also due to higher capital adequacy ratios and an improved European regulatory framework, which has further developed in the meantime.

More recently, we have seen a decline in the share of non-performing loans (NPLs) in euro area banks. This is mainly due to the extraordinary measures taken by

countries to support the economy and the moratoria imposed on banks, which have limited the build-up of non-performing loans. As a result, bank profitability has not declined over the period.

The capital adequacy of banks remained broadly stable, above minimum requirements. This is confirmed by the latest results of the stress tests carried out by the ECB and EBA. They have shown that the euro area banking system is resilient to crises. And it is worth underlining that these stress scenarios were particularly severe in 2021.

Moreover, as I said earlier, the enlarged mandate of ESM, when ratified, will include the common backstop to the Single Resolution Fund, which can be called in crisis times to resolve failing banks, providing an important additional safety net.

When do you expect this treaty to be fully ratified?

Early next year. Most euro area countries are already in the process of ratification, the majority have already completed it and others will complete it early in 2022.

So there is a broad political will in the eurozone to jointly help countries in need, while giving new powers to the ESM?

Yes, this will was expressed in the political agreement on the reform of the ESM reached at the end of last year by the finance ministers of the euro area. The political will is also demonstrated by the fact that the changes have already been approved in many parliaments and there is willingness to see the process through to the end.

Will the risks of the current and future crises in Europe be better managed, will we be better prepared financially for a similar crisis to the one triggered by the pandemic last year?

The ESM reform is meant to contribute to greater financial stability and resilience of the euro area to new shocks.

**What are the main risks facing the euro area and the Union as a whole?
What do countries need to pay particular attention to?**

In the short term, the rise in infections may trigger tighter restrictive measures that could put the brakes on the economy's recovery. This can happen even in countries

with higher vaccination rates. Faster vaccination and government support to affected businesses can mitigate the effects of the current wave. Bottlenecks in supply chains, which are already constraining the supply of products, and the rising energy prices, will also have an impact on the recovery.

However, I would like to stress that the European Commission's €750 billion NextGenerationEU recovery instrument supports economic reforms of the countries emerging from the pandemic, as well as green and digital transitions. If countries successfully implement the measures proposed in their recovery and resilience plans, they will sustainably strengthen their economic growth. Successful implementation of these plans is therefore a key task for all Union Member States over the next five years.

And one more thing: do you in the ESM also deal in any way with countries in the Union that do not (yet) have the euro, such as neighbouring Croatia, the Czech Republic, Poland, Hungary, etc.?

Countries that are not members of the euro area are also not members of the ESM. When a country joins the euro, it automatically joins the ESM. But we are no stranger to working with countries outside the euro. An example is the common backstop to the Single Resolution Fund. The SRF supports banks in countries that are part of the banking union but not members of the euro. Those countries can, in the future, benefit from the ESM.

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